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Subject: Sam A. Francis Benevolent Trust

Requested by: Darris L. Russell, Muhlenberg County Attorney

Written by: Matt James¹

Syllabus: Some of the proposed terms of the trust violate the mandatory provisions of Kentucky's codification of the Uniform Trust Code. However, this would not cause the trust to fail in whole or in part, and the conflicting proposed terms would yield to the mandatory Code provisions as necessary.

Statutes construed: KRS 386B.1-030, KRS 386B.4-020, KRS 386B.5-020, KRS 386B.8-010

Opinion of the Attorney General

To honor the memory of his son, Samuel S. Francis (hereinafter the "Settlor") has proposed to fund the Sam A. Francis Benevolent Trust for the benefit of the employees of the Muhlenberg County Sheriff Department. In a letter written by the Settlor and forwarded to the Office of the Attorney General by Muhlenberg County Attorney Darris L. Russell, the Settlor provides the names of two individuals who shall serve as co-trustees, describes when distributions from the trust may occur, describes how the trust will initially be funded, and provides the conditions upon which the trust shall terminate. The letter also specifies that "all the standard and applicable terms and conditions used in the various trusts for which my son was a beneficiary/member . . . will be included in the [trust]."

¹ This opinion is indebted in its entirety to the work of former Assistant Attorney General Joseph A. Newberg, II.

Attached to the letter is a copy of one of those trust agreements.² You ask whether those terms and conditions would be a “violation of any Kentucky or local statute.” We advise that some of the proposed terms conflict with mandatory provisions of Kentucky trust law. However, we further advise that the trust would not fail in whole or in part and that the conflicting provisions would simply yield to the mandatory provisions as far as is necessary.

KENTUCKY TRUST LAW

Trusts in Kentucky are governed by the Commonwealth’s 2014 codification of the Uniform Trust Code (the “Code”), KRS Chapter 386B. Due to the recency of Kentucky’s adoption of the Code, little Kentucky case law interpreting the Code exists. Where necessary, this analysis will refer to the Code’s drafters’ notes (which, while not binding authority, are a useful interpretive tool), the law from other jurisdictions that have adopted the Code, and the common law of trusts as decided prior to the enactment of the Code. *See* KRS 386B.1-040 (“The common law of trusts and principles of equity supplement this chapter, except to the extent modified by this chapter or another statute of this Commonwealth.”)

In general, the Code provides default rules for trust administration that govern except where the terms of the trust provide otherwise. KRS 386B.1-030(1). *See also In re Morgenstern*, 542 B.R. 650, 656 n. 6 (Bankr. D.N.H. 2015). “While this Code provides numerous procedural rules on which a settlor may wish to rely, the settlor is generally free to override these rules and to prescribe the conditions under which the trust is to be administered.” UNIF. TRUST CODE § 105 cmt. (amended 2005). However, the terms of a trust may not prevail over certain mandatory provisions listed in KRS 386B.1-030(2). *E.g., Rafert v. Meyer*, 859 N.W.2d 332, 340 (Neb. 2015). This opinion focuses on whether any of the proposed terms of the trust violate any of the mandatory rules enumerated in KRS 386B.1-030(2).

² For the purposes of this opinion, we assume that Articles IV and V of the attached trust agreement are the “standard/applicable” terms. We will also assume that the references to Nevada law in sections 4.1 and 5.2 will be amended to reflect the applicability of Kentucky law.

The Code's Mandatory Provisions

A. Requirements for creating a trust (KRS 386B.4-020)

KRS 386B.4-020 sets out the five requirements for the creation of a trust. First, the settlor must have "capacity to create the trust." KRS 386B.4-020(1)(a). For the purposes of this opinion, we presume that the Settlor is of sound mind and has the requisite "capacity" to transfer the property to the trust. *See* UNIF. TRUST CODE § 402 cmt. (200); *see also* RESTATEMENT (THIRD) OF TRUSTS § 11(3) cmts. a-d (2003) ("To have mental capacity to make an irrevocable inter vivos gift, the donor must have the mental capacity necessary to make or revoke a will and must also be capable of understanding the effect that the gift may have on the future financial security of the donor and of anyone who may be dependent on the donor.").

Second, the Settlor must "indicate[] an intention to create a trust." KRS 386B.4-020(1)(b). The Settlor must manifest this intention, typically in writing, at the time the trust is created. *See Frazier v. Hudson*, 130 S.W.2d 809, 810-11 (Ky. 1939). We advise that a written trust instrument identifying the subject property, the trustee, the beneficiaries, and the duties of the trustee, as those terms have been described by the Settlor in his letter, would satisfy KRS 386B.4-020(1)(b). *See Frazier*, 130 S.W.2d at 810-11.

Third, the Settlor must identify a "definite beneficiary" unless the trust is a charitable trust, a trust for the care of an animal, or a trust for a noncharitable purpose. KRS 386B.4-020(1)(c). The Settlor has identified a class of beneficiaries: "the employees of the Muhlenberg County Sheriff Department." During the life of the trust, it is likely that the makeup of this class will change as employees join and leave the Muhlenberg County Sheriff's Department. However, "the definite beneficiary requirement does not prevent a settlor from making a disposition in favor of a class of persons." UNIF. TRUST CODE § 402, cmt. (2000); *accord* RESTATEMENT (THIRD) OF TRUSTS § 45 cmt. a. (2003). Further, "a class is not indefinite for this purpose merely because it consists of a changing or shifting group, the number of whose members may increase or decrease." *Id.* Accordingly, we

advise that the terms proposed by the Settlor regarding the trust beneficiaries do not conflict with KRS 386B.4-020(c).³

Fourth, the Settlor must provide the trustee with "duties to perform." KRS 386B.4-020(d). Recognized duties include "determining and assuring, or exercising discretion with respect to, the benefits and equitable rights of beneficiaries." RESTATEMENT (THIRD) OF TRUSTS § 6 cmt. d. (2003) Here, the proposed trust provides that a sum certain "shall be paid" upon the death of a beneficiary, and the trustees "are authorized, in their sole discretion," to pay up to a certain amount when a beneficiary is injured. Since the trustees will have active duties to perform, we advise that the proposed terms of the trust do not conflict with KRS 386B.4-020(d).

Fifth, KRS 386B.4-020(e) provides that a trust is created only where "the same person is not the sole trustee and the sole beneficiary." Here, there are multiple trustees and multiple beneficiaries, and we advise that the proposed terms do not conflict with KRS 386B.4-020(e).

B. Duty of a trustee to act in good faith and in the interests of the beneficiaries (KRS 386B.8-010)

The Code requires trustees to "administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with [the Code]." KRS 386B.8-010. Bad faith is more than mere negligence or a simple error in judgment; it "implies some intentional wrongful conduct." *Blue Cross and Blue Shield of Kentucky, Inc. v. Whitaker*, 687 S.W.2d 557, 559 (Ky. Ct. App. 1985). Bad faith encompasses acting "in reckless disregard of beneficiaries' rights." *Anderson v. Old Nat. Bancorp*, 675 F. Supp. 2d 701, 712 (W.D.

³ The trust could alternately be viewed as a charitable trust, which the Code defines as a trust created "for the relief of poverty, the advancement of education or religion, the promotion of health, governmental or municipal purposes, or other purposes the achievement of which is beneficial to the community." KRS 386B.4-050. In that case, the identification of a definite beneficiary or group of beneficiaries is not required. See KRS 386B.4-020. Here, the proposed trust is arguably for "governmental or municipal purposes, or other purposes the achievement of which is beneficial to the community." However, for the purposes of this opinion, it is not necessary to determine whether a court would view the trust as an express trust with a class of beneficiaries or a charitable trust, as the proposed terms comply with KRS 386B.4-020(1)(c) in both instances.

Ky. 2009). Bad faith on the part of a trustee may also “contemplate a state of mind affirmatively operating with a furtive design or with some motive or self-interest or ill will, or for an ulterior purpose.” *Id.* (citing *Warfield Nat. Gas Co. v. Allen*, 59 S.W.2d 534, 538 (Ky. 1933)).

The proposed terms are silent as to the trustees’ standard of care with regard to the beneficiaries’ rights. Further, nothing in the proposed terms suggests that the trustees are required to act dishonestly, maliciously, with reckless disregard for the rights of the beneficiaries, or otherwise in “bad faith.” We advise that the proposed terms do not conflict with KRS 386B.8-010.

- C. Trust and its terms must be for the benefit of its beneficiaries and must have a purpose that is lawful, not contrary to public policy, and possible to achieve (KRS 386B.4-040)

The purpose of the trust is to provide monetary benefits to employees of the Muhlenberg County Sherriff’s Department and their families when an employee of the department is injured or killed in the line of duty. We need not resort to an in-depth legal analysis to advise that this purpose is lawful, not contrary to public policy, and possible to achieve, and thus is not in conflict with KRS 386B.4-040.

- D. Power of court to change or terminate a trust under subchapter 4 of the Code (KRS 386B.4-100)

Under the Code, courts are empowered to approve or disapprove modifications, terminations, and reformations, combinations, and divisions of trusts. *See* KRS 386B.4-100 (citing KRS 386B.4-110 to KRS 386B.4-170). Nothing in the proposed terms purports to bar the courts from exercising these powers. We advise that the proposed terms do not conflict with KRS 386B.4-100.

- E. Effect of a spendthrift provision and the rights of certain creditors and assignees to reach a trust as provided in subchapter 5 of the Code

A “spendthrift trust” is “a trust in which by the terms of the instrument creating it a valid restraint on the voluntary and involuntary alienation of the

interest of a beneficiary is imposed." KRS 386B.5-020(1). Article V, § 3 of the trust includes a spendthrift provision:

No beneficiary of this trust estate shall have any right or power to anticipate, pledge, assign, sell, transfer or alienate (by operation of law, legal process, or otherwise) or encumber his or her interest (in income and principal) in any trust, in any way; nor shall any interests in any manner be liable for or subject to the debts, liabilities or obligations of such beneficiary or claims of any sort against such beneficiary.

Given of the inclusion of the spendthrift provision, the proposed trust is a spendthrift trust. KRS 386B.5-020(1). In spite of these proposed restraints on alienation, however, the Code provides that the interests of trust beneficiaries shall be subject to the satisfaction of three types of enforceable claims against beneficiaries:

- (a) By the spouse or child of the beneficiary for support, or by the spouse for maintenance;
- (b) If the trust is not [an individual retirement account or annuity, tax-sheltered annuity, simplified employee pension, pension, profit-sharing, stock bonus, or other retirement plan described in the Internal Revenue Code of 1986, as amended, which qualifies for the deferral of current income tax until the date benefits are distributed], by providers of necessary services rendered to the beneficiary or necessary supplies furnished to him;
- (c) By the United States or this Commonwealth for taxes due from him or her on account of his or her interest in the trust or the income therefrom.

KRS 386B.5-020. Accordingly, the spendthrift provision fails if a beneficiary of a Kentucky trust is subject to a claim for spousal maintenance or child support, a claim by someone such as a "physician or grocer" who renders necessary services or furnishes necessary supplies, or a tax lien related to the trust. *See* RESTATEMENT (THIRD) OF TRUSTS § 59 (2003) (describing "necessary" goods and services). As a result, a beneficiary's interest in the trust could be reached by

those three (3) narrow categories of debtees. Therefore, we advise that the spend-thrift provision, Article V, § 3, conflicts with KRS 386B.5-020.

F. Power of court under KRS 386B.7-020 to require, dispense with, or modify or terminate a bond

Under the Code, the court may require a trustee to give bond "if the court finds that a bond is needed to protect the interests of the beneficiaries or is required by the terms of the trust and the court has not dispensed with the requirement." Article IV, § 8 of the proposed terms provides that "[n]o trustee shall be required to post bond or surety." We advise that, on its face, this term conflicts with KRS 386B.7-020.

G. Power of court under KRS 386B.7-080(2) to adjust a trustee's compensation as specified in the terms of the trust which is unreasonably low or high

The Code provides that the court "may allow more or less compensation" than that which is specified by the terms of the trust. KRS 386B.7-080. Here, no term of the proposed trust sets trustee compensation or purports to deny the court the power to adjust compensation. We advise that the proposed terms do not conflict with KRS 386B.7-080.

H. Trustees' duty to notify and report under KRS 386B.8-130(2)

Under the code, a trustee "shall have a duty to notify and to report to at least one (1) qualified beneficiary of an irrevocable trust . . . of the existence of the trust, of the identity of the trustee, and of his or her right to request trustee's reports. KRS 386B.8-130(2). Here, no proposed term purports to remove this duty. We advise that the proposed terms do not conflict with KRS 386B.8-130(2).

I. Effect of an exculpatory term under KRS 386B.10-080

Certain terms relieving a trustee of liability for breach of trust are unenforceable. KRS 386B.10-080. Under the Code, an unenforceable exculpatory term is one that "(a) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests

of the beneficiaries; or (b) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor." *Id.* No proposed term of the trust provides relief from liability for a breach committed in bad faith or with reckless indifference. Further, you have informed us of no fiduciary or confidential relationship between the Settlor and the trustees that would animate this statute. Based upon the information that you have presented, we advise that the proposed terms thus do not conflict with KRS 386B.10-080.

J. Rights of a person other than a trustee or beneficiary under KRS 386B.10-100, KRS 386B.10-110, and KRS 386B.10-120

The Code provides for certain limitations on the personal liability of: a trustee (KRS 386B.10-100), those who deal with a trustee in his capacity as trustee (KRS 386B.10-110), and those who rely upon a certification of trust prepared by a trustee (KRS 386B.10-120). None of the proposed terms impose liability upon those who deal with a trustee or those who rely upon a certification of trust prepared by a trustee. Article IV, § 7 of the proposed terms, relating to liability of successor trustees, does not purport to impose the liability limited by KRS 386B.10-100. We advise that the proposed terms do not conflict with KRS 386B.10-100, KRS 386B.10-110, or KRS 386B.10-120.

K. Period of limitation for commencing a judicial proceeding (KRS 386B.6-040, KRS 386B.10-050)

The Code provides for a period of limitations on certain actions relating to trusts in KRS 386B.6-040 and KRS 386B.10-050. The proposed terms of the trust are silent as to periods of limitations. Accordingly, we advise that the proposed terms do not conflict with KRS 386B.6-040 or KRS 386B.10-050.

L. Power of court to take such action and exercise such jurisdiction as may be necessary in the interests of justice

This mandatory provision requires that the terms of a trust not deny a court authority to take such action as "necessary in the interests of justice." UNIF. TRUST CODE § 105 cmt. (amended 2005). The interests of justice could require a trustee to give bond. *Id.* As discussed above, Art. IV, § 8 of the proposed terms

provides that "no trustee shall be required to post bond or surety." We advise that this term is in conflict with the mandatory provisions of the Code.

M. Subject-matter jurisdiction of court and venue for commencing a proceeding as provided in KRS 386B.2-030 and KRS 386B.2-040

Finally, the Code specifies that District and Circuit Court shall have concurrent subject-matter jurisdiction over actions related to the trust unless a statute provides otherwise. KRS 386B.2-030. The Code also dictates where venue is proper for actions related to the trust. KRS 386B.2-040. Because the proposed terms are silent as to subject-matter jurisdiction and venue, we advise that they are not in conflict with KRS 386B.2-030 or KRS 386B.2-040.

Conclusion

While certain of the proposed terms conflict with the mandatory provisions of the Code, we advise that the trust would not fail in whole or in part. Instead, the conflicting terms would yield to the mandatory terms to the extent necessary while the non-conflicting terms remain intact. *See Rafert*, 859 N.W.2d at 340.

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